

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 99-0581
Gross Retail Tax
For the Tax Years 1996, 1997, and 1998

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

I. Purchases Subject to Use Tax.

Authority: IC 6-2.5-5-3; IC 6-2.5-5-3(b); IC 6-8.1-5-1(b); Indiana Dept. of State Revenue v. Cave Stone, 457 N.E.2d 520 (Ind. 1983); General Motors Corp. v. Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991); Mumma Bros. Drilling Co. v. Dept. of Revenue, 411 N.E.2d 676 (Ind. Ct. App. 1980); 45 IAC 2.2-3-4; 45 IAC 2.2-4-27(c); 45 IAC 2.2-5-8(h); 45 IAC 2.2-5-8(j).

Taxpayer protests the imposition of use tax against the purchase of certain equipment, supplies, and capital assets.

II. Abatement of the Ten-Percent Negligence Penalty.

Authority: IC 6-8.1-10-2.1; IC 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer requests that the Department abate the ten-percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana based manufacturer of aluminum granules. Taxpayer sells the finished granules to aluminum manufacturers. The Department of Revenue (Department) conducted an audit of taxpayer's business records. The audit determined that taxpayer was liable for additional use tax occasioned by the acquisition of tools, equipment, office supplies, computer supplies, shipping equipment, and various other items not directly implicated in the direct production of taxpayer's aluminum granules. In addition, the audit determined that certain items were used in both a taxable and nontaxable manner; accordingly, the audit determined additional tax liability on an apportioned basis.

The taxpayer protested the audit's determinations arguing that the audit's findings were arbitrary, capricious, and were made without an adequate basis in fact or law. In addition, the taxpayer challenged – as fundamentally flawed – the apportionment methods employed during the audit. Taxpayer asserted that the apportionment methods were, in themselves, arbitrary and whimsical.

Taxpayer was provided the opportunity to take part in an administrative hearing during which the taxpayer would be permitted to fully explain the substantive basis for its protest. Taxpayer

declined the opportunity to participate in such a hearing. Taxpayer was invited to submit additional information substantiating the basis for its protest. Again, taxpayer declined to provide that information and, instead, relied on the initial assertions as set out in its correspondence and discussions with the Department.

DISCUSSION

I. Purchases Subject to Use Tax.

During its review of purchases made during the audit period, the auditor found that taxpayer had not paid sales tax on purchases for which sales tax should have been initially collected. Those purchases thereby became subject to use tax pursuant to 45 IAC 2.2-3-4. That regulation states as follows: “Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.” The audit assessed use tax because the purchased items under consideration were not entitled to one of the sales tax exemptions otherwise available to the taxpayer.

The audit assessed use tax for maintenance tools, equipment, and associated supplies. The assessment was made pursuant to 45 IAC 2.2-5-8(h) which imposes the use tax on equipment which is “predominately used to maintain production equipment” In addition, the audit assessed use tax on “man-lift” rentals pursuant to 45 IAC 2.2-4-27(c), and on supplies used in the normal repair and maintenance of taxpayer’s building under 45 IAC 2.2-5-8(j).

The audit determined that certain of taxpayer’s equipment and supplies were used in both a taxable and non-taxable manner. Accordingly, the audit apportioned the use tax liability based upon the manner in which that equipment and those supplies were employed within taxpayer’s manufacturing process.

The audit determined that certain supplies and equipment, used in taxpayer’s general and administrative operations, were subject to use tax under the provisions of 45 IAC 2.2-5-8(j). The assessed equipment included office and computer equipment used in the taxpayer’s administrative operations.

Taxpayer protested the audit’s findings arguing that those findings were arbitrary, capricious, and lacked an adequate basis in fact or law. In essence, taxpayer argued that it would not have incurred any of the expenses – for which the auditor assessed use tax – unless those expenses were in some way related to the taxpayer’s manufacturing operation. Moreover, the taxpayer argued that the manner in which the audit apportioned the use tax on equipment and supplies which were employed in both a taxable and non-taxable manner, was whimsical and arbitrary.

The Legislature has granted Indiana manufacturers a sales tax exemption for certain purchases. IC 6-2.5-5-3(b) states, “Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring the property acquires it for *direct* use in the *direct* production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.” (*Emphasis added*).

However, in enacting the stringently worded exemption, the Legislature clearly did not intend to create a global exemption for any and all equipment which a manufacture purchased for use within its manufacturing facility. “Fairly read, the exemption was meant to apply to capital equipment that [meets] the ‘double direct’ test.” Mumma Bros. Drilling Co. v. Dept. of Revenue, 411 N.E.2d 676, 678 (Ind. Ct. App. 1980). The capital equipment “in order to be exempt, (1) must be *directly* used by the purchaser and (2) be used in the *direct* production, manufacture, fabrication, assembly, extraction, mining, processing, refining or finishing of tangible personal property.” Indiana Dept. of State Revenue v. Cave Stone, 457 N.E.2d 520, 525 (Ind. 1983). “[t]he test for directness requires the equipment to have an ‘immediate link with the product being produced.’” Id. Accordingly, the sales tax exemption is applicable to that equipment which meets the “double direct” test and is “essential and integral” to the manufacture of taxpayer’s tangible personal property. General Motors Corp. v. Dept. of State Revenue, 578 N.E.2d 399, 401 (Ind. Tax Ct. 1991).

The Indiana courts have attempted to clearly define the boundaries of the manufacturing exemption. Taxpayer is entitled to his view that, in view of the practical realities of its own complex manufacturing process, the test set out IC 6-2.5-5-3 admits of certain vagaries. However, in determining whether taxpayer’s own purchases fall within the statute’s boundaries – as with all tax exemptions – “[t]he taxpayer claiming [the] exemption has the burden of showing the terms of the exemption statute are met.” Id. at 404. (Internal citations omitted). “Exemption statutes are strictly construed because an exemption releases property from the obligation of bearing its fair share of the cost of the government.” Id.

Taxpayer admits that it bears the “responsibility of taxes for expenses where such are related to tangential or support systems.” However, taxpayer’s proposed test, whereby all expenses “associated with the movement, processing, packaging and maintenance of [taxpayer’s] product and process equipment . . .” are entitled to the manufacturing exemption, is itself totally without foundation. Taxpayer has failed to meet its burden of demonstrating that the audit’s determinations – distinguishing between equipment and supplies falling inside and outside the exemption’s boundaries – were unreasonable or unjustified by either fact or law.

Taxpayer argued that the audit’s decisions, concerning the apportionment of use taxes to equipment used for both taxable and non-taxable purposes, were arbitrary and fundamentally flawed. However, taxpayer has utterly failed to provide any substantive evidence refuting the audit’s apportionment determinations.

“The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made.” IC 6-8.1-5-1(b). The taxpayer has provided the Department nothing which would enable it to provide taxpayer the requested relief.

FINDING

Taxpayer’s protest is respectfully denied.

II. Abatement of the Ten-Percent Negligence Penalty.

The audit assessed the ten-percent negligence penalty against taxpayer. The taxpayer protests imposition of that penalty assessment. IC 6-8.1-10-2.1 requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. Department regulation 45 IAC 15-11-2 provides guidance in determining if the taxpayer was negligent.

Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

IC 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed"

Taxpayer argues that it "employs the most diligent controls to assure the proper payment of sales or use tax based upon the based available understanding of IDR rules." In addition, the taxpayer claims that the assessment is "offensive and fundamentally unfair." However, it should be noted that the taxpayer underwent a prior audit during which nearly identical use tax issues were raised. Subsequently, the taxpayer lodged a protest, a hearing was held, and a Letter of Findings was issued. That earlier Letter of Findings clearly and unmistakably delineated the standards applicable to the manufacturing exemption. In addition, that earlier Letter of Findings granted the taxpayer's request to abate the ten-percent negligence penalty because "the taxpayer had a bona fide dispute with the Department's interpretation of the tax laws." No such conclusion is possible here.

FINDING

Taxpayer's protest is respectfully denied.